ORIGINAL

In the
Supreme Court of Ohio

NAVISTAR, INC.,	:
Appellant,	:
	:Case No. 2014-0140
v.	:
	: Appeal from Ohio Board of Tax Appeals
JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO,	:Case No. 2010-575
Appellee.	:

MERIT BRIEF OF APPELLEE TAX COMMISSIONER

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Under the plain meaning of R.C. 5753.51(A)(6)(b) and(A)(10), Navistar's CAT credit claim fails because Navistar's GAAP-compliant, restated financial statements for the 2004 fiscal year-end showed that Navistar's Ohio NOL carryforwards were subject to a 100% valuation allowance, resulting in a zero dollar realizable value. 19

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Proposition of Law No. 5

Contrary to Navistar's argument, R.C. 5751.53(D)'s imposition of a June 30 deadline for taxpayers to file a CAT credit claim with the Commissioner does not somehow bar the Commissioner from using a taxpayer's subsequently filed GAAP-compliant restated 2004 financial statements to audit and correct errors in the amount of the credit.

In fact, R.C. 5751.53(D) expressly requires the Commissioner to audit and make corrections to the amount of the credit prior to a June 30, 2010 audit deadline. 26

Proposition of Law No. 6:

As all three of Navistar's accounting witnesses testified to upon cross-examination and the Commissioner's independent accounting expert testified on direct examination, in accordance with GAAP, the books and records relating to Navistar's deferred tax assets that Navistar used to restate its 2004 values were based on the very same historical data comprising "Navistar's books and records" that Navistar used to determine the realizable value of deferred tax assets as originally filed. 29

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I. INTRODUCTION/SUMMARY

The appellant, Navistar, Inc. ("Navistar"), seeks a $27 million commercial activity tax ("CAT") credit under R.C. 5751.53. In its decision below, the Ohio Board of Tax Appeals ("BTA") upheld the Commissioner's final determination denying Navistar's tax credit claim in its entirety. *Navistar, Inc. v. Levin*, BTA No. 2010-575 (Dec. 31, 2013), unreported (hereafter *BTA Decision and Order*), Appx. 1-8.

Navistar predicates its tax credit claim on the assertion that certain of its Ohio deferred tax assets were worth several hundred million dollars as of Navistar's October 31, 2004 fiscal year-end, despite Navistar's own restated financial statement disclosures for the 2004 fiscal year showing that, as of the 2004 fiscal year-end, those Ohio deferred tax assets had "*zero*" realizable value under generally accepted accounting principles ("GAAP").

In this appeal, Navistar tax credit claim rests on its originally filed, *non-GAAP-compliant* financial statements for the 2004 fiscal year. Navistar persists in its argument that the Commissioner's determination of the CAT credit should be restricted to Navistar's originally filed financial statements for the 2004 fiscal year, despite the admitted inaccuracies contained therein, rather than on its restated, *GAAP-compliant* financial statements for that year.

Unsurprisingly, Navistar's claim to the CAT credit is refuted under the plain meaning of R.C. 5751.53, as buttressed by a developed body of Ohio Supreme Court and Board of Tax Appeals case law. The Commissioner and the BTA lawfully so held. In his final determination the Commissioner summarized his holding as follows:

> Although the taxpayer's representative argues for the use of the prior, superseded financial statements rather than the corrected and revised financial statements, ***Ohio law*** requires that the corrected financial statements be used.

Tax Commissioner's Final Determination at 2-3 (emphasis added), reproduced in the statutory transcript of evidence certified by the Commissioner to the BTA ("St.") at 2-3 and in Appellant's Supplement ("Supp.") at Supp. 2-3.

In affirming the Commissioner's use of Navistar's GAAP-compliant, restated financial statements (rather than Navistar's originally filed, but non-GAAP-compliant financial statements), the BTA strongly agreed with the Commissioner's application of the plain meaning of a key provision of the CAT credit statute, R.C. 5751.53(A)(10).

The BTA rejected Navistar's argument that the Commissioner erred in relying on Navistar's restated, *GAAP-compliant* financial statements. The BTA held that Navistar's reliance on its originally filed, non-GAAP compliant financial statements: "is in contradiction with R.C. 5751.53 (A)(10) which requires that such statements be "prepare[d] and issue[d] *** *in accordance with generally accepted accounting principles*." (Emphasis added by the BTA.) *Navistar, Inc. v. Levin*, BTA No. 2010-575 (Dec. 31, 2013), unreported (hereafter *BTA Decision and Order*) at 7, Appx. 7; see also, *Tax Commissioner's Final Determination* at 2, Supp. 2.

Further, as had the Commissioner in his final determination, in rejecting Navistar's argument, the BTA followed well-settled Ohio corporate franchise tax law for the established principle that a business taxpayer's restated books and records are the appropriate books to use when a taxpayer corrects its books to amend a discrepancy found later. *BTA Decision and Order* at 7-8, Appx. 7-8 (citing *Shook Natl. Corp. v. Tracy*, BTA No. 1990-X-1596 (Dec. 23, 1992), unreported, Appx. 9-17; *Natl. Tube Co. v. Peck*, 159 Ohio St. 98 (1953); and *SHV N. Amer. Corp. v. Tracy*, 70 Ohio St.3d 395 (1994)).

By contrast to the Commissioner's and BTA's application of R.C. 5751.53's plain language, Navistar's attempts to avoid altogether the plain meaning of R.C. 5751.53 (A)(10).

Remarkably, Navistar fails to address directly, let alone rebut effectively, the Commissioner's and BTA's application of the plain meaning of R.C. 5751.53(A)(10). Navistar's initial merit brief *never* acknowledges the existence of R.C. 5751.53(A)(10)'s definition of "books and records" -- pursuant to which, as noted, the General Assembly requires the CAT credit to be determined using GAAP-compliant books and records only.

Similarly, Navistar's brief *never* mentions *National Tube*; *SHV North America*, or *Shook National Bank*, despite the Commissioner's concise, three-page final determination's emphasis on these three cases and the BTA's express reliance on those decisions as buttressing authority. [1]

The testimony at the BTA hearing on behalf of the Commissioner of Dr. Ray Stephens provides compelling confirmation of the reasonableness and lawfulness of the BTA's affirmance of the Commissioner's denial of the CAT credit claim. As a former senior academic fellow at the Office of Chief Accountant of the Securities and Exchange Commission ("SEC") and long-time director of the School of Accountancy at Ohio University, Dr. Stephens' expertise on matters of GAAP and SEC financial disclosure is well established and recognized by this Court. *UBS Fin. Servs. v. Levin*, 119 Ohio St.3d 286, 2008-Ohio-3821, ¶¶ 22, 28; and *Rich's Dep't Stores, Inc. v. Levin*, 125 Ohio St.3d 15, 2010-Ohio-957, ¶¶ 7, 18-19.

After a thorough discussion of the operation of the relevant accounting principles as applied to Navistar's GAAP-compliant, *restated* financial statement disclosures, in his BTA testimony, Dr. Stephens concluded that the Commissioner properly determined that Navistar was not entitled to any R.C. 5751.53 CAT credit based on those restated, GAAP-compliant figures. See particularly, Dr. Stephens' BTA testimony at volume I of the hearing transcript ("Tr. I.") at

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[1] The amicus brief filed in support of Navistar's appeal follows the lead of Navistar's merit brief by likewise failing to even acknowledge, let alone attempt to refute, the Commissioner's and BTA's reliance on the plain meaning of R.C. 5751.53(A)(10) and the Ohio case law under the Ohio corporate franchise tax law.

171, 172, Supp. 355-356 (in which Dr. Stephens concluded that Navistar's restated books and records for the 2004 fiscal year-end showing a 100% full valuation allowance against its U.S. and Canadian deferred tax assets negated its CAT credit claim, reducing the amount of the CAT credit to zero). And revealingly, Navistar's opening brief never challenges even one aspect of Dr. Stephens' testimony.

Finally, even if there could be any real doubt about the Commissioner's and BTA's application of R.C. 5751.53 in this case, this Court would be required to "strictly construe" the credit against Navistar, and resolve that doubt in favor of upholding the Commissioner's denial of the credit. This is so because the General Assembly's grant of tax credits is a matter of legislative grace, in derogation of the rights of all other taxpayers, who must thereby pay a disproportionate tax burden. A large and uniform body of this Court's case law has expressly so held.[2]

For all these reasons, as we amplify below, the Court should affirm the BTA's decision upholding the Commissioner's denial of the CAT credit claim.

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[2] See, most recently, *Anderson/Maltbie P'ship v. Levin*, 127 Ohio St.3d 178, 2010-Ohio-4904, ¶16; *Chapel v. Testa*, 129 Ohio St.3d 21, 2011-Ohio-545, ¶ 25; *Bay Mechanical & Elec. Corp. v. Testa*, 133 Ohio St.3d 423, 2012-Ohio-4312, ¶15. Thus, "the claimant must bear the burden to show that it meets the statutory prerequisites for the tax exemption or reduction." *Chapel*, at ¶ 25. "In all doubtful cases," the claim must be resolved against the asserted statutory tax reduction. *Anderson/Maltbie* at ¶ 16; *Bay Mechanical* at ¶ 15.

II.STATEMENT OF CASE AND FACTS

A. Some uncontroverted, basic legislative facts regarding the R.C. 5751.53 credit.

1.Ohio net operating loss carryforwards ("NOL carryforwards") are a form of "deferred tax asset" arising under the Ohio corporate franchise tax.

In 2005, pursuant to R.C. 5751.53, the General Assembly granted a tax credit under the commercial activity tax ("CAT") to taxpayers that had been subjected to the Ohio corporation franchise tax ("CFT') in prior tax years, and who now would be subject to the CAT. The General Assembly based the R.C. 5751.53 CAT credit on the taxpayer's unused Ohio "net operating loss carryforwards" that the taxpayer had accumulated under the CFT during previous tax years, but that had remained unused as of the taxpayer's 2004 fiscal year-end.

The concept of Ohio "net operating loss carryforwards" derives from the CFT, which like the CAT, is an annual Ohio "privilege of doing business tax." In 2005, the four-year phase-out of the CFT commenced, replaced by the CAT[3], which was "phased-in" effective beginning in mid-2005. Until its repeal for most taxpayers effective in 2009, corporations doing business in Ohio were subject to the CFT under either the "net income" basis or the "net worth" basis, whichever resulted in greater tax liability. See R.C. 5733.04 and .05.

Under the CFT's net-income basis for determining CFT liability, if a taxpayer in a particular taxable year had more Ohio operating expenses than Ohio operating income (so that the taxpayer incurred an Ohio "net operating loss" or "NOL" for that year), the General Assembly allowed the taxpayer to "carry forward" the unused NOL for a certain additional

[3] See, this Court's detailed description of the enactment of the CAT in *Ohio Grocers Ass'n v. Levin*, 123 Ohio St.3d 303, 2009-Ohio-4872, ¶ 6.

number of tax years, as an offset against the taxpayer's positive Ohio net operating income in those future tax years. See R.C. 5733.04(I)(1)[4].

In granting a tax deduction under the CFT for Ohio NOL carryforwards, the General Assembly merely paralleled the federal income tax benefit granted by Congress to corporations for NOL "carryforwards" (referred to as "carryovers") under Sections 172, 381 and 382 of the Internal Revenue Code. In fact, the expiration dates for NOL carryforwards set forth in R.C. 5733.04(I)(1) simply follow in lockstep the expiration dates for NOL carryforwards set forth in I.R.C. Section 172. Through the R.C. 5733.04(I)(1) and Sections 172, 381, and 382 of the Internal Revenue Code, the General Assembly and Congress, respectively, created what in accounting and financial statement parlance is referred to as a "deferred tax asset" in the form of "NOL carryforwards."

To summarize, pursuant to R.C. 5751.53, the General Assembly grants a CAT credit measured by certain "deferred tax assets" consisting of Ohio "net operating loss carryforwards" that, as of the taxpayer's 2004 fiscal year-end, the taxpayer had accrued, but had been unable to use to reduce its Ohio corporate franchise tax ("CFT") liabilities under the "net income" basis for previous tax years.

2. The R.C. 5751.53 credit is measured by the realizable value of the qualifying Ohio NOL carryforwards as of the taxpayer's 2004 fiscal year-end.

As noted, generally speaking, the R.C. 5751.53 credit is based on taxpayer's "NOL carryforwards" accumulated by the taxpayer under the CFT. For purposes of this appeal, however, a more precise description of the measure of the CAT credit is necessary. Specifically,

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[4] The expiration period for the NOL carryforwards depends on the particular taxable year in which the NOLs were originally incurred, ranging from a five-, fifteen-, or twenty- year expiration period, which tracks the parallel provision of the Internal Revenue Code, 26 U.S.C. 172(b)(1)(ii) (currently providing for "a net operating loss carryover to each of the 20 taxable years following the taxable year of the loss").

the R.C. 5751.53 credit is measured by the "realizable value" of certain "deferred tax assets," consisting of:

> The *gross amount* of the taxpayer's Ohio "net operating loss carryforwards" ("NOL carryforwards") as *multiplied by* a "*valuation allowance*," resulting in *net* realizable value.

See specifically, R.C. 5751.53(A)(6)(b) which requires, for purposes of determining the amount of the CAT credit, that a taxpayer's NOL carryforwards, as accumulated through the 2004 fiscal year, "shall be reduced by the taxpayer's qualifying related valuation allowance," *** as "shown on its [the taxpayer's] books and records on the last day of its taxable year ending in 2004."

So long as the CFT continued in full force, the General Assembly had no need to limit the amount of the Ohio NOL carryforwards to their "realizable value," because the Ohio NOL carryforwards could be deducted dollar-for-dollar against a corporation's future net income, until the expiration years of the NOL carryforwards. But, because the CAT is measured by "gross receipts" rather than "net income," when the CAT was enacted, the General Assembly then had to find a reasonable way to quantify the true value of the Ohio NOL carryforwards and convert them from a tax "deduction" to a tax "credit." R.C. 5751.53(A)(6)(b) constitutes the General Assembly's methodology to achieve that result.

For purposes of determining the amount of CAT credit under R.C. 5751.53(A)(6)(b), a taxpayer's gross amount of Ohio NOL carryforwards, as of its 2004 fiscal year-end, must be reduced to realizable value through the application of a "valuation allowance," as shown on the taxpayer's "books and records" for the 2004 fiscal year-end.

3. R.C. 5751.53(A)(6)(b)'s "realizable value" requirement parallels the SEC-financial statement disclosure and GAAP requirements for determining the book value of a taxpayer's NOL carryforwards and other deferred tax assets.

R.C. 5751.53's requirement that the *gross* amount of a company's Ohio NOL carryforward assets must be reduced to their *net* realizable value by application of a "valuation allowance" parallels financial statement disclosure requirements imposed by the U.S. Securities and Exchange Commission ("SEC"). These SEC financial disclosure rules require a company's financial statements, and the company's underlying accounting books and records, to comply with generally acceptable accounting principles ("GAAP").

In turn, under GAAP, the financial statement reporting of a company's "deferred tax assets," including the company's NOL carryforwards, must comply with "FASB Statement No. 109"[5], BTA Jt. Ex. D, Supp. 766-849. Pursuant to ¶¶ 8 and 17 (e) of FASB Statement No. 109, the valuation of a company's items of deferred tax assets must be reported at "realizable" value. The gross amount of the deferred tax assets must be reduced through the application of a "valuation allowance," whenever the company's management and its CPA auditors determine that it is "more likely than not" that all or a portion of the deferred tax assets will not be realized. *Id*, Supp. 773-774, 777.[6]

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[5] Statement of Financial Accounting Standards No. 109 of the Financial Accounting Standards Board, captioned "Accounting for Income Taxes," BTA Jt. Ex. D (hereafter often referred to as "FASB Statement No. 109"), Supp. 766-849.

[6] At the BTA hearing, the Commissioner's expert accounting and SEC financial disclosure witness, Dr. Ray Stephens, further explained how the gross amount of deferred tax assets, such as NOL carryforwards, are reduced to their realizable value, citing and discussing FASB Statement No. 109 at ¶¶ 17-25, BTA Jt. Ex. D, Supp. 777-779. See the discussion of Dr. Stephens' BTA testimony at Tr. I. 100 -105, 128-135, Supp. 284-288, 312-319.

B.Statement of Facts

Because Navistar is a publicly-held company and files detailed financial statements with the Securities and Exchange Commission ("SEC"), many of the facts that we rely on are established directly from Navistar's SEC-filed financial statements. As outlined above, under R.C. 5751.53, the "date certain" upon which Navistar's "amortizable amount" is determined is as of its fiscal year-end in 2004, i.e., October 31, 2004.

Originally, Navistar filed its income statement and balance sheet ("statement of financial condition") for its fiscal year ending ("f/y/e") October 31, 2004 pursuant to an annual SEC Form 10-K. See BTA Joint Ex. F, Supp. 1164-1403. Navistar filed that original 2004 Form 10-K with the SEC on February 14, 2005. As part of its reporting, Navistar reported a "gross" deferred tax asset amount of $1,522,000,000, which was offset by a "valuation allowance" of $76,000,000, for a net deferred tax asset amount of $1,446,000,000. *Id.* at 48 (also identified as "NAV 0056"), Supp. 1219. Navistar's claim to a $27,000,000 CAT credit is predicated on the Ohio net operating loss carryforward portion of the "deferred tax asset" values set forth on Navistar's originally filed 2004 SEC Form 10-K.

Subsequent investigation and review of Navistar's originally filed 2004 Form 10-K, however, caused Navistar to fire its previous outside CPA auditor, Deloitte and Touche, L.L.P. ("Deloitte") and issue "a massive restatement of its financial statements for fiscal years 2003, 2004 and the first three quarters of 2005." See ¶ 3 of the Complaint filed by Navistar against Deloitte, *Navistar International Corporation v. Deloitte & Touche, L.L.P.*, U.S. District Court for the Northern District of Illinois, Case # 1:11-cv-0357 ("Complaint"), BTA Commissioner Ex. 8 (a full and complete copy of Navistar's Complaint that was filed in the Circuit Court of Cook

County, Illinois on April 26, 2011 and then removed to U.S. District Court for the Northern District of Illinois on May 25, 2011).[7]

Navistar made its massive restatement of the financial statements for fiscal years 2003, 2004 and the first three quarters of 2005 in its annual Form 10-K for the f/y/e October 31, 2005, which was filed with the SEC on December 7, 2007. BTA Joint Ex. G ("Restatement Financials"), Supp. 850-1163. See particularly, the Restatement Financials at 3, Supp. 855.

These Restatement Financials reflected substantial reductions to Navistar's income and assets as previously reported for f/y/e 2004 (as well as for its f/y/e 2002, its f/y/e 2003, and for the first three quarters of fiscal year 2005). The material reductions in asset values included Navistar's reducing the value of its U.S. and Canadian "net operating losses" **to zero** for f/y/e 2004. Navistar applied a "full valuation allowance" against its gross NOLs and other deferred tax assets. That full valuation allowance totaled $1.7 billion as of November 2002 and resulted in a drastic reduction of Navistar's previously stated "deferred tax assets" by $1.4 billion as of

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[7] Pursuant to the Complaint, Navistar alleged that Deloitte fraudulently induced Navistar to file materially erroneous financial statements for the fiscal years ending in 2003, 2004 and the first three quarters of 2005, which caused Navistar to issue "a massive restatement of its financial statements for fiscal years 2003, 2004 and the first three quarters of 2005." See, e.g., Complaint at ¶ 3, BTA Commissioner Ex. 8 at 2. The Complaint consists of 134 numbered pages and 422 paragraphs of detailed allegations, as well as several hundreds of pages of Exhibits (Exs. A-G thereto). These allegations and exhibits provide a "chapter and verse" recitation of material errors in Navistar's originally filed Forms 10-K for f/y/e in 2003 and 2004 and for the quarterly filed Forms 10-Q for the first three quarters of 2005. Navistar's Complaint also details Navistar's and its external CPA auditors' gross departures from GAAP in materially overstating Navistar's income and asset values.

For purposes of its suit against Deloitte, Navistar has asserted that each of the allegations in its Complaint is true to the best of its knowledge and belief. The Complaint constitutes a thorough set of "admissions against interest" that, as an evidentiary matter, the Commissioner and any reviewing tribunal properly may rely on in establishing and amplifying the relevant facts. These representations detail Navistar's and Deloitte's failure to comply with GAAP and the resultant material errors in determining the value of its income and assets, including its overstatement of its "deferred tax assets" by over $1 billion. See particularly Complaint at ¶¶ 12, 21, 37, 101, 125, 127, 201, 268-276 (collectively under the caption "Deferred Taxes"), 292, 305-306.

October 31, 2004. See BTA Joint Ex. G at numbered pages 107 and 108, Supp. 961-962; Commissioner's statutory transcript of evidence certified to the BTA ("St. __") at St. 33-34, Supp. 33-34.

In its Restatement Financials, Navistar explained the reasons for its drastic reduction in the value of its net U.S. and Canadian NOLs and other deferred tax assets to zero, in part, as follows:

> We reassessed our need for a valuation allowance and determined that **we did not apply FASB Statement No. 109 properly** and that a full valuation allowance should be established for net U.S. and Canadian deferred tax assets based on the weight of positive and negative evidence, particularly our recent history of operating losses.

Id. at 107 (Emphasis added), Supp. 961; *BTA Decision and Order* at 7-8, fn. 5 (quoting this financial statement disclosure).

As testified by the Commissioner's identified SEC financial disclosure and accounting expert, Dr. Ray Stephens, FASB [Financial Accounting Standards Board] Statements constitute the highest authority under "generally accepted accounting principles" ("GAAP"). Tr. I. at 20, Supp. 204. Thus, Navistar's acknowledgment that it "did not apply FASB Statement No. 109 properly" constituted an admission by Navistar that it had not applied GAAP properly in its previously filed Forms 10-K for the f/y/e in 2002, 2003, and 2004. See BTA Joint Ex. D (a full copy of FASB Statement No. 109, captioned "Accounting for Income Taxes"), Supp. 766-849; and Dr. Stephens' testimony at Tr. I. at 111-112, Supp. 295-296.

By taking a "full valuation allowance" against its net U.S. and Canadian deferred tax assets, Navistar restated the value of its NOLs and other deferred tax assets from over a billion dollars to zero dollars. In reducing the values of Navistar's NOLs to zero for the fiscal years ending in 2002, 2003, and 2004, Navistar and its outside CPA auditors represented to the SEC

and to all users of Navistar's financial statements that the Restatement Financials were in compliance with GAAP.[8]

As detailed in Navistar's Complaint filed against Deloitte regarding its originally filed financial statements for 2002-2005, and by Navistar's own SEC filings, Navistar's "massive restatement" of its financial statements for 2002-2005 was preceded by external investigation and review by federal regulators. The Public Company Accounting Oversight Board ("PCAOB") and the SEC began a detailed audit beginning in mid-2004. See Complaint at ¶¶ 161-171. During the ensuing year and a half, external and internal pressures concerning Navistar's financial statement compliance with GAAP led Navistar to fire Deloitte as it long-standing outside CPA auditor. See Complaint at ¶¶ 183-190.

In April 2006, long before Navistar's filing of its Restatement Financials on December 7, 2007, and several months before Navistar filed its "Amortizable Amount Report" with the Commissioner, Navistar had apprised the SEC and the public of the necessity to issue restated financial statements for 2003, 2004, and the first three quarters of 2005. See Navistar's Form 8-K dated April 7, 2006, BTA Commissioner Ex. 4. Pursuant to "Item 4.02 Non-Reliance on Previously Issued Financial Statements ***" of the Form 8-K, Navistar disclosed to the SEC and the public that "because of errors in such financial statements," Navistar's "previously issued financial statements and the independent auditors' reports thereon for the years ended October 31, 2002 through October 31, 2004, and all quarterly financial statements for periods after November 1, 2002 shall no longer be relied on ***[.]" See *id.* at page 3 of the Form 8-K.

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[8] For the representations of Navistar's outside CPA auditors, see the Restatement Financials, BTA Joint Ex. G, at numbered page 72 (the Report of Navistar's outside CPA firm auditors, KPMG LLP), Supp. 925. For the representations of Navistar's management, see the signature page for Navistar's Restatement Financials, at numbered page E-56, E-57 (signed by Navistar's controller and principal accounting officer, John P. Walton), avowing that the Restatement Financials are being signed pursuant to "Section 13 or 15(d) of the Securities and Exchange Act of 1934" (requiring that financial statements must be in compliance with GAAP), Supp. 1150-1151. See Dr. Stephens' BTA testimony at Tr. I. 139, Supp. 329.

Navistar identified the focus of its "errors" in applying GAAP to be in eleven primary subject areas, including "the accounting for deferred income tax assets."

At the same time, and in the same Form 8-K, Navistar notified the SEC and the public that it was terminating the services of its previous outside auditor, Deloitte, and engaging a new outside auditor, KPMG LLP ("KPMG"). See "Item 4.01 Dismissal of Current Accountants," id at pages 1 and 2. In response, and as requested by Navistar, Deloitte responded with a letter to Navistar and addressed to the SEC. See Navistar's Form 8-K A dated April 6, 2006, BTA Commissioner Ex. 5.

On June 23, 2006, Navistar filed its "Amortizable Amount Report" with the Commissioner, claiming an R.C. 5751.53 CAT credit of $27,048,726. See St. 57, with attachments thereto, St. 58-63, reproduced as BTA Joint Ex. E. Navistar conveyed its "Amortizable Amount Report" as an attachment to a June 23, 2006 letter to the Tax Commissioner's CAT Division from Navistar's then-Assistant Director of Tax, Susan Penway. See St. 117 (reproduced as BTA Commissioner Ex. 6), Supp. 117.

Through Ms. Penway's June 23, 2006 letter, Navistar notified the Commissioner that Navistar was, at that time, "currently undergoing a restatement examination of its financial statements for the years 2002, 2003, 2004 and 2005," and that Navistar "believe[d] that changes will be made to the 2002, 2003, 2004 financial statements as part of that examination **which will impact the return and report [the "Amortizable Amount Report"]**." (Emphasis added.)

In its decision below, the BTA expressly noted Ms. Penway's representations to the Commissioner, as follows:

> Although appellant insists that the commissioner acted improperly by considering the and relying upon its later restated financial statements, at the time of its filing of its amortizable amount report with the Department of Taxation, appellant's assistant director of tax [Ms.

> Penway] expressly disclosed that it was "currently undergoing a restatement of its financial statements for the years 2002, 2003 and 2004 and 2005. We believe that changes will occur to the 2002, 2003 and 2004 financial statements as part of this examination which will impact the return and the report that we are filing today."

BTA Decision and Order at 6, quoting from Ms. Penway's June 23, 2006 letter, reproduced as T.C. Ex. 6, Supp. 117.

Pursuant to R.C. 5751.53(D), the Commissioner's audit division then conducted an audit of Navistar's Amortizable Amount Report, reducing the claimed credit from $27,048,726 to $0 on the basis of Navistar's filing of restated financial statements for the f/y/e October 31, 2004. In filing its "Amortizable Amount Report," Navistar based its claim to a $27 million credit on its annual financial statement for the fiscal year ending October 31, 2004 as originally filed with the SEC on February 14, 2005. See BTA Joint Ex. F, Supp. 1164-1403, and BTA Commissioner Ex. 6, Supp. 117.

The Commissioner's auditing staff took the exact course of action suggested in Ms. Penway's June 23, 2006 letter: by relying on the Restatement Financials to determine Navistar's claimed credit. See the Tax Commissioner's Executive Administrator of Audit Division Administration, Ron Pottorf's, June 8, 2009 letter to Navistar's then-outside counsel, Laura Kulwicki (explaining the Commissioner's basis for reducing Navistar's amortizable amount to zero). St. 14-15 (reproduced as BTA Commissioner Ex. 7), Supp. 14-15.

Thereafter, on January 11, 2010, the Commissioner issued a final determination denying Navistar's CAT credit claim in its entirety. The Commissioner reiterated the reasoning that Executive Administrator Pottorf had expressed in his June 8, 2009 letter for readjusting Navistar's amortizable amount to zero dollars, together with case law citations and analysis. See St. 1-3. Supp. 1-3.

Finally, in both Navistar's merit brief and the amicus brief in support of Navistar, allusions are made to Navistar's financial condition and reporting for fiscal year 2011, pursuant to which, *on a prospective basis*, the valuation allowances for Navistar's deferred tax assets were eliminated. See Navistar's merit brief at 14, 20 and the brief of the amici in support of Navistar at 13.

In stark contrast to the Restatement Financials that Navistar filed in 2007 to restate its financial statements for fiscal years 2002-2005 to provide for 100% valuation allowances against Navistar's NOL carryforwards and other deferred tax assets, Navistar's financial statements for 2011 did not restate, in any way, any of Navistar's previous fiscal year financial statements.

Contrary to the bare assertion in Navistar's and the amici's briefing, the prospective change of the valuation allowances in 2011 in no way "reinstated" for any earlier periods the net realizable value of Navistar's Ohio NOL carryforwards, or any of Navistar's other deferred tax assets. Indeed, in 2011, Navistar's NOL carryforwards and other tax deferred tax assets would not be the same deferred tax assets. (For example, at that point, because of the repeal of the Ohio corporate franchise tax as applied to general taxpayers like Navistar, in 2011 Navistar had no Ohio NOL carryforwards.) As explained in detail, supra at 6, fn. 4, NOL carryforwards, if not used to offset positive income during their carrying periods, expire as worthless. Thus, separated by seven full years, the nature and kind of the state and federal NOL carryforwards that Navistar held at its 2011 fiscal year end would necessarily differ significantly from those it held as of its 2004 fiscal year end.

Any further facts will be referenced directly to the evidentiary record in the Law and Argument Section which follows.

III.LAW AND ARGUMENT

Proposition of Law No. I

Tax reduction statutes are strictly construed against the party claiming the tax reduction because they are a matter of legislative grace and in derogation of the rights of all other taxpayers who must bear a disproportionate tax burden.

In the proceedings below, the Commissioner issued a final determination affirming his auditing staff's denial of a tax "credit" sought by Navistar against its commercial activity tax ("CAT") liability pursuant to R.C. 5751.53 and the BTA affirmed the Commissioner's final determination on appeal. By this appeal, Navistar seeks this Court to reverse the BTA's affirmance of the Commissioner's final determination and grant Navistar a $27 million claimed credit against its future CAT liability for taxable periods beginning in 2010. See R.C. 5751.53(B) (providing that the credit may be applied against a qualifying taxpayer's CAT liability beginning for the 2010 calendar year and ending in calendar year 2030, with the remainder to be refunded at that time back to the taxpayer).

This Court must strictly construe statutory tax credits, deductions, exemptions, exclusions, and other statutory tax reductions because such reductions are "in derogation of equal rights" and a "matter of legislative grace." *Anderson/Maltbie P'ship v. Levin*, 127 Ohio St.3d 178, 2010-Ohio-4904, ¶ 16; *Westinghouse Electric Corp. v. Lindley* 58 Ohio St.2d 137(1979); *Ares, Inc. v. Limbach*, 51 Ohio St.3d 102 (1990); and *Chapel v. Testa*, 129 Ohio St.3d 21, 2011-Ohio-545, ¶ 25; *Bay Mechanical & Elec. Corp. v. Testa*, 133 Ohio St.3d 423, 2012-Ohio-4312, ¶15.

The claimant must bear the burden to show that it meets the statutory prerequisites for the tax exemption or reduction." *Chapel*, at ¶ 25. The "onus is on the taxpayer to show that the language of the statute 'clearly expresses the exemption' in relation to the facts of the claim."

Anderson Maltbie at ¶ 16 (quoting *Ares, Inc. v. Limbach*, 51 Ohio St.3d 102, 104 (1990); and *Bay Mechanical* at ¶ 15 (same). Thus, "in all doubtful cases," the claim must be resolved against the asserted statutory tax reduction." *Anderson/Maltbie* at ¶ 16.

Augmenting this "strict interpretation of credit claims" standard, the Commissioner's findings in his final determinations must be affirmed by the BTA, unless the appellant demonstrates that those findings are "clearly unreasonable or unlawful." *Am. Fiber Sys. v. Levin*, 125 Ohio St.3d 374, 2010-Ohio-1468, ¶ 42 (quoting *Hatchadorian v. Lindley*, 21 Ohio St.3d 665 (1986), paragraph one of the syllabus). It is incumbent on the appellant to show "in what manner and to what extent" the Commissioner's final determination was erroneous. *Am. Fiber Sys.* at ¶ 48 (quoting *Federated Dept. Stores, Inc. v. Lindley* (1983), 5 Ohio St.3d 213, 215). To reverse the Commissioner's findings, as affirmed by the BTA, Navistar must show clear entitlement to the credit, both factually and legally, and demonstrate the Commissioner's denial of the credit to be clearly unreasonable and unlawful.

If there is any doubt concerning the interpretation of the applicable law or the supporting facts weighing against Navistar's claim to the credit, it must fail[9]. In the present case, however, the Court's recourse to the "strict construction" and evidentiary burden principles applicable to tax credit claims and the Commissioner's findings is not necessary for affirmance here. As we detail below, in affirming his auditing staff's denial of Navistar's CAT credit, the Commissioner applied the plain meaning of the relevant statutory provisions, as well as a developed body of guiding decisional law.

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[9] In their opening merit briefs, Navistar and the amici suggest that the General Assembly may have projected that the R.C. 5751.53 CAT credit would result in more loss of tax revenue than what actually occurred. But, because the CAT credit statute is a tax reduction statute, any doubt concerning the meaning and operation of the credit must be resolved against the claim of tax reduction, regardless of the magnitude of the reduction. See Proposition of Law No. 1, supra. Moreover, by any measure, the magnitude of the revenue loss resulting from the CAT credit is substantial -- several hundred million dollars.

Proposition of Law No. 2

Under their plain meaning, R.C. 5751.53(A)(6)(b) and R.C. 5751.53(A)(10) require the realizable value of a taxpayer's NOL carryforwards to be based on GAAP-compliant books and records only.

The R.C. 5751.53 tax credit is measured by the taxpayer's realizable value of certain "deferred tax assets," consisting of Ohio "net operating loss carryforwards" ("NOL carryforwards") held by the taxpayer as of the taxpayer's 2004 fiscal year-end, as shown on the taxpayer's own *GAAP-compliant* "books and records." The requirement that the realizable value of a taxpayer's Ohio NOL carryforwards must be determined using *GAAP-compliant* books and records follows directly from the plain meaning of two provisions of R.C. 5751.53, R.C. 5751.53(A)(6)(b) and R.C. 5751.53(A)(10).

First, R.C. 5751.53(A)(6)(b) limits the amount of the qualifying Ohio NOL carryforwards to their net realizable value by requiring a taxpayer's gross amount of qualifying NOL carryforwards to be reduced by the "related valuation allowance amount ... as shown on the taxpayer's *books and records* on the last day of its taxable year ending in 2004 (emphasis added)."

In turn, R.C. 5751.53(A)(10), defines "books and records" for purposes of this Section to mean:

> [T]he qualifying taxpayer's books, records, and all other information, all of which the qualifying taxpayer maintains and uses to prepare and issue its financial statements in *accordance with generally accepted accounting principles*.

(Emphasis added.)

Under the plain meaning of R.C. 5751.53(A)(10) and R.C. 5751.53(A)(6)(b), in determining the realizable value of Navistar's NOL carryforwards as of Navistar's 2004

fiscal year-end, the Commissioner must use only those of Navistar's books and records that comply with GAAP.

Proposition of Law No. 3

Under the plain meaning of R.C. 5753.51(A)(6)(b) and(A)(10), Navistar's CAT credit claim fails because Navistar's GAAP-compliant, restated financial statements for the 2004 fiscal year-end showed that Navistar's Ohio NOL carryforwards were subject to a 100% valuation allowance, resulting in a zero dollar realizable value.

The Commissioner's auditing staff applied the plain meaning of the foregoing statutes to deny Navistar's CAT claim on the basis of Navistar's GAAP-compliant books and records showing the realizable value of Navistar's Ohio NOL carryforwards as of the October 31, 2004 fiscal year-end. In fact, the Commissioner's auditors relied on the *best possible evidence* of Navistar's GAAP-compliant "books and records." Namely, the Commissioner's auditing staff relied on Navistar's own *CPA-audited* restated financial statements for that fiscal year-end, as set forth on Navistar's annual Form 10-K filed with the SEC for the 2005 fiscal year, BTA Jt. Ex. G (often referred to hereafter as "Restatement Financials"), Supp. 850-1163.

Because Navistar was (and is) a publicly traded company, Navistar's restated financial statements were required to be filed with the SEC and were required to be certified as GAAP-compliant by Navistar's top management and Navistar's outside certified accounting firm auditors, KPMG LLP. See the various certifications so stating in the Restatement Financials and Dr. Stephens' testimony concerning those certifications; Tr. I. 135-139 (Dr. Stephens' testimony), Supp. 314-318, and BTA Jt. Ex. G at 72 (KPMG LLP's "Report of Independent Registered Accounting Firm," Supp. 925, and at E-56 and E-57 (certifications of Navistar's CEO

and CFO that the Restatement Financials are filed in compliance with Sections 13(a) and 15(d) of the Securities and Exchange Act of 1934 and are GAAP-compliant[10]), Supp. 1150-1151.

In its Restatement Financials, among many other major reductions in asset values to comply with GAAP, Navistar was required to restate and correct its *prior misapplication* of GAAP on its originally SEC-filed financial statements for its 2003 and 2004 fiscal years regarding its "*deferred tax assets*." In order to comply with FASB Statement No. 109, for both its 2003 and 2004 fiscal year financial statements, Navistar's Restatement Financials reduced the realizable value of Navistar's U.S. and Canadian deferred tax assets, including all of Navistar's Ohio NOL carryforwards, to *zero* dollars, by applying a *full 100% value allowance* to Navistar's total U.S. and Canadian deferred tax assets, as follows:

> We reassessed our need for a valuation allowance and determined that **we did not apply FASB Statement No. 109[11] properly** and that a **full valuation allowance should be established for net U.S. and Canadian deferred tax assets** based on the weight of positive and negative evidence, particularly our recent history of operating losses.

(Emphasis added). Ex. G at 107 under the Financial Note caption for "Income Taxes."[12] Supp. 961. See also Ex. G at 90 under the caption, "Income Taxes," Supp. 944.

In restating its U.S. and Canadian deferred tax assets' realizable value to zero dollars for the 2003 and 2004 fiscal years, Navistar expressly recognized the importance of its "recent

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[10] See Dr. Stephens' testimony at Tr. I. 139, Supp. 323.

[11]FASB Statement of Accounting Standards No. 109, captioned "Accounting for Income Taxes," is the highest GAAP authority on the subject of deferred tax assets. As Dr. Ray Stephens, the Commissioner's expert accounting and SEC financial statement disclosure expert testified, under the hierarchy of GAAP, the highest level of GAAP authority is set forth in the "Statements of Financial Standards" of the Financial Accounting Standards Board ("FASB"). See Dr. Stephen's BTA hearing transcript ("Tr. I.") at 20, 89-92. And, on the subject of deferred tax assets, FASB Statement of Accounting Standards No. 109," is the highest GAAP authority. Id. at Tr. I. 96-97, Supp. 280-281.

[12]See also, Navistar's quantification of the Restatement Financial reductions of the net realizable value of its total foreign and U.S. deferred tax assets for the fiscal years ending in 2003 and 2004 in its Restatement Financials, BTA Jt. Ex. G, at 143-144, Supp. 997-928.

history of operating losses" as constituting "negative evidence" regarding the realizable value of its NOL carryforwards and other deferred tax assets. *Id.* at 90 and 107, Supp. 944, 961. Navistar's recent history of operating losses constituted "negative evidence" concerning whether Navistar would be able to utilize its deferred tax assets to offset future income (and thereby reduce its taxes). See FASB Statement No. 109, "Accounting for Income Taxes," BTA Jt. Ex. D, at ¶ 23, Supp. 778; see also Dr. Stephens' testimony at Tr. I. 102-105, Supp. 285-288, and Carol Garnant's testimony at Tr. II 350-352, 358-359, Supp. 534-536, 542-543.

In its Restated Financials, for the same 2003 and 2004 fiscal years, in order to comply with GAAP, Navistar drastically reduced and restated its previously stated net income for its 2003 and 2004 fiscal years ends by over *$573 million* [13]. Largely upon consideration of that GAAP-corrected "negative evidence" of Navistar's *income* history for the 2003 and 2004 fiscal years, Navistar and its CPA firm auditing firm, KPMG LLP, determined that GAAP also required Navistar to reduce its NOL carryforwards and other deferred tax assets to zero, by taking a full 100% valuation allowance for both the 2003 and 2004 fiscal year-ends.

Navistar's issuance of its *GAAP-compliant* "books and records" for the 2004 fiscal year-end, in the form of Navistar's Restatement Financials and the underlying books and records upon which the Restatement Financials were based, provided the Commissioner's auditing staff with a reasonable and lawful basis to deny Navistar's CAT credit claim in its entirety. Because those Restatement Financials set forth a *zero* net realizable value for all of Navistar's then-existing deferred tax assets, including Navistar's Ohio NOL carryforwards, the Commissioner's auditing staff did not have to conduct a full-scale audit concerning any other aspect of the calculation of

[13] See the Restatement Financial, Ex. G at 75 (showing Navistar's restated "net income" for its 2003 and 2004 fiscal year-ends, in the amounts of a $333 million loss and a $44 million loss, respectively), Supp. 92 , and compare to Navistar's originally filed Form 10-K for the 2004 fiscal year, EX. F at 35 (showing Navistar's originally reported net income for the 2003 fiscal year in the amount of only a $17 million loss and for the 2004 fiscal year to a net income gain of $247 million for the 2004 fiscal year), Supp. 1206 .

the CAT credit amount. Instead, the Commissioner's auditing staff could, and did, properly summarily reject Navistar's CAT credit claim as meritless.

By contrast, as Navistar expressly admitted in its Restated Financials, the value of its U.S. and Canadian deferred tax assets as set forth in its originally SEC-filed financial statements for the 2004 fiscal year, BTA Jt. Ex. F, did *not* comply with FASB Statement No. 109 -- the highest GAAP authority. The reason why it did not comply followed directly from the failure of Navistar's originally filed financial statements for the 2003 and 2004 fiscal years to reflect GAAP net income. As noted above, for those two years alone, after Navistar correctly applied GAAP in its Restatement Financials, Navistar reduced its previously stated net income for those years by $573 million.

Under these facts and circumstances, at the BTA evidentiary hearing, Dr. Stephens concluded his direct testimony with a clear and unequivocal conclusion as to the proper amount of Navistar's CAT credit: Dr. Stephens stated that the Commissioner was correct in his application of the statute denying Navistar any CAT credit because the Commissioner properly relied on Navistar's GAAP-compliant restated "deferred asset values," for the applicable October 31, 2004 fiscal year-end, which applied a full 100% valuation allowance against Navistar's U.S. and Canadian deferred tax assets, as required under R.C. 5751.53(A)(6)(b) and R.C. 5751.53(A)(10). See Tr. I at 171-172, Supp. 355-356.

Rather than challenge Dr. Stephens' application of the plain meaning of R.C. 5751.53(A)(6)(b) and R.C. 5751.53(A)(10), at the BTA, Navistar, instead, chose to challenge Dr. Stephens' credentials as an accounting expert. Navistar's challenge is both untimely and unfounded. *First*, at the BTA evidentiary hearing, the presiding BTA attorney-examiner rejected Navistar's challenge See BTA Attorney-Examiner Rebecca Luck's ruling at Tr. II 402, which

the BTA reaffirmed in its decision on the merits, see *BTA Decision and Order* at 6-7, fn. 4, Appx. 4. *Second*, Dr. Stephens' accounting credentials are impeccable and extensive. See his curriculum vitae (Navistar Ex. 1); as well as his extensive consulting and expert SEC financial disclosure and expert accounting witness testimony as set forth in the Commissioner's BTA Exs. 1-3.

Dr. Stephens' expertise concerning GAAP is both comprehensive and deep, and includes demonstrated knowledge and expertise concerning the application of GAAP on the topic of Deferred Income Taxes. For example, Dr. Stephens' demonstrated knowledge and expertise concerning Deferred Income Taxes includes Dr. Stephens' authoring of that portion of an "Advanced Accounting" college textbook covering "Deferred Income Taxes," see Tr. I. at 21-22, Supp. 204-205; and presenting seminars to CPA professionals on the topic of FASB Statement No. 109, see Tr. I. at 25-26, Supp. 209-210.

In fact, on two widely different GAAP accounting issues, the Ohio Supreme Court twice has expressly recognized and found authoritative Dr. Stephen's accounting expertise on "generally accepted accounting principles" and SEC financial statement disclosure matters. See, *UBS Fin. Servs. v. Levin*, 119 Ohio St.3d 286, 2008-Ohio-3821, ¶¶ 22, 28; and *Rich's Dep't Stores, Inc. v. Levin*, 125 Ohio St.3d 15, 2010-Ohio-957, ¶¶ 7, 18-19.

In sum, the BTA properly affirmed the Commissioner's rejection of Navistar's CAT credit claim. The BTA and the Commissioner applied the plain meaning of R.C. 5751.53(A)(6)(b) and R.C. 5751.53(A)(10). See the *Commissioner's Final Determination* at St. 1-2 (finding that under Navistar's GAAP-compliant financial statements for the 2004 fiscal year-end, Navistar's books and records reflected a full "100% valuation allowance" which reduced the

gross value of Navistar's Ohio NOL carryforwards to a net realizable value of zero), Supp. __-__; and the *BTA Decision and Order* at 5-8, Appx. 5-8.

Proposition of Law No. 4

R.C. 5751.53 (A)(10)'s definition of "books and records" to include only GAAP-compliant books and records codifies pre-existing Ohio Supreme Court case law under the "net worth" basis of the Ohio corporate franchise tax.

The Commissioner's and BTA's application of the plain meaning of R.C. 5751.53(A)(1) is buttressed by the decisional law under the "net worth" basis of the Ohio corporate franchise tax ("CFT") law. See *BTA Decision and Order* at 7-8 (citing and discussing *Shook National Bank v. Tracy*, BTA No. 90-X-1596 (Dec. 23, 1992), unreported; *National Tube v. Peck*, 159 Ohio St. 98 (1953); and *SHV North America Corp. v. Tracy*, 70 Ohio St.3d 395 (1994), Appx. 7-8; and the *Commissioner's Final Determination* ; St. 1-2, Supp. 1-2.

As the Board explained in *Shook*, under the "net worth" basis of the CFT, a taxpayer is subject to the CFT based on the "values of its shares," otherwise known as "net worth" and, in determining that "net worth," "a corporation is bound by its books and records as kept in the ordinary course of business." *Shook* at 14 (citing to *National Tube*).

Further, under *National Tube* and *SHV*, to be validly used for determining a corporation's net worth, the corporation's books and records must be kept "in accordance with any sound and generally recognized and approved accounting system." In other words, in current accounting parlance, the corporation's books and records must be kept "in accordance with generally accepted accounting principles." See *Shook* at 15.

Accordingly, when a corporate taxpayer amends its books for a previous fiscal year to correct for errors in GAAP for that previous fiscal year, the Commissioner must use the GAAP-

compliant books for that previous fiscal year-end, rather than the taxpayer's uncorrected, non-GAAP-compliant books. *Shook* at 17. That scenario was precisely the situation presented in *Shook*, wherein the corporate taxpayer initially filed its 1987 Ohio CFT return based on the "net worth" that was set forth on its 1986 year-end books and records. Later, after the taxpayer had filed its 1987 CFT return, the taxpayer discovered that certain asset values on its 1986 and 1987 books were overvalued in violation of GAAP, requiring the taxpayer to correct its 1986 and 1987 books to comply with GAAP. Under the authority of *National Tube*, the BTA in *Shook* required the Commissioner to compute the corporate taxpayer's net worth using its restated, GAAP-corrected books, rather than the uncorrected net worth set forth on its previous, non-GAAP-compliant books. Id. at 21-22. As noted by the Commissioner, *Shook*'s facts mirror those at issue here. See the *Tax Commissioner's Final Determination* at 2, Supp. 2.

Following the BTA's issuance of *Shook*, a year later this Court reiterated that only GAAP-compliant books and records may be used to determine a corporation's net worth under the net worth basis of the Ohio corporate franchise tax. *Gray Horse, Inc. v. Limbach*, 66 Ohio St.3d 631. In *Gray Horse*, the Court determined, based on the testimony of two CPA witnesses, the books and records of the corporate taxpayer relied upon by the Tax Commissioner to determine the taxpayer's net worth (relating to the taxpayer's federal income tax liabilities) were *not* in accordance with GAAP. *Id.* at 633. Instead, the Court required the Commissioner to use the corporation's GAAP-compliant books. *Id.* at 633-644.

In sum, R.C. 5753.51(A)(10)'s definition of "books and records" codifies the "GAAP" requirements established by this Court's decisional law under the net worth basis of the CFT, under which only GAAP-compliant books may be used to determine a taxpayer's net worth. The General Assembly's codification of decisional law standard under the CFT accords with the

nature of the CAT as the successor tax to the CFT. By requiring the use of the taxpayers' own GAAP-compliant books and records to determine the amount of the R.C. 5751.53 CAT credit, the General Assembly considerably reduced administrative burdens imposed on taxpayers to comply with the CAT, and upon the Commissioner to audit the CAT credit claim.

Proposition of Law No. 5

> *Contrary to Navistar's argument, R.C. 5751.53(D)'s imposition of a June 30 deadline for taxpayers to file a CAT credit claim with the Commissioner does not somehow bar the Commissioner from using a taxpayer's subsequently filed GAAP-compliant restated 2004 financial statements to audit and correct errors in the amount of the credit.*
>
> *In fact, R.C. 5751.53(D) expressly requires the Commissioner to audit and make corrections to the amount of the credit prior to a June 30, 2010 audit deadline.*

Throughout its opening brief, Navistar insists that the Commissioner is somehow barred from using Navistar's GAAP-corrected, restated financial statements to determine the amount of Navistar's CAT credit on the asserted ground that Navistar issued its GAAP-compliant restated financial statements in December of 2007, i.e., only after the June 30, 2006 deadline for taxpayers to file their R.C. 5751.53 CAT credit claims (pursuant to an "Amortizable Report). Unfortunately for Navistar, its "statutory filing deadline" argument is easily refuted for two fundamental reasons.

First, Navistar's argument is refuted by the plain terms of R.C. 5751.53(D) itself. For the Court's convenience, R.C. 5751.53(D) provides, in pertinent part, as follows:

> Not later than June 30, 2006, each qualifying taxpayer, consolidated elected taxpayer, or combined taxpayer that will claim for any year the credit allowed in divisions (B) and (C) of this section shall file with the tax commissioner a report setting forth the amortizable amount available to such taxpayer and all other related information that the commissioner, by rule, requires. *** Unless extended by mutual consent, the **tax commissioner may, until June 30, 2010, audit the accuracy of the amortizable amount available to each taxpayer that will claim the credit**, and **adjust the amortizable amount** or, if

> appropriate, issue any assessment or final determination, as applicable, **necessary to correct any errors found upon audit.**

(Emphasis added.)

As shown, R.C. 5751.53(D) does provide a June 30, 2006 deadline for a taxpayer's *filing* of its R.C. 5751.53 CAT credit claim, but as the emphasized language above shows, that Section also provides a *June 30, 2010* deadline for the Commissioner to "*audit the accuracy*" of the CAT credit claim and to "*adjust the amount if necessary to correct any errors found upon the audit.*" To audit the accuracy of the CAT credit claim, the Commissioner must determine whether the realizable value of the taxpayer's NOL carryforwards as of the 2004 fiscal year-end complies with GAAP. It is the June 30, 2010 deadline that actually operates as an effective deadline for the Commissioner's use of a taxpayer's GAAP-compliant, restated 2004 financial statements, not the June 30, 2006 deadline for taxpayers to file their CAT credit claims.

In fact, in the present case, the Commissioner's auditing staff did just that. Led by audit administrator Ron Pottorf, the Commissioner's auditors utilized the disclosures in Navistar's restated financial statement for the 2004 fiscal year-end to "correct errors" in Navistar's amortizable amount resulting from Navistar's reliance on its originally filed, non-GAAP compliant financial statements for the 2004 fiscal year.

Because R.C. 5751.53(D) gives the Commissioner the power and duty to audit and correct any errors in the amortizable report until June 30, 2010, then surely the June 30, 2006 filing deadline does not have the limitation that Navistar suggests. Why would the General Assembly allow the Tax Commissioner to audit the amortizable amount until June 30, 2010, and in that same paragraph take that power away? Such a reading would violate the most basic principle of statutory interpretation, which requires that a statute must be interpreted in a way that gives effect to all language in the statute, if reasonably possible. R.C. 1.47(B); *Church of*

God in N. Ohio v. Levin, 124 Ohio St.3d 36, 2009-Ohio-5939, ¶ 30, citing *State ex rel. Bohan v. Indus. Comm.* 147 Ohio St. 249, 251(1946) (courts should "'accord meaning to each word of a legislative enactment if it is reasonably possible to do so'").

Second, Navistar's claim that the June 30, 2006 deadline for a taxpayer's filing of its amortizable report somehow bars the Commissioner from using a subsequently filed GAAP-corrected, restated financial statement directly conflicts with R.C. 5751.53(A)(10)'s definition of "books and records." Under that broad definition, the phrase includes: "the qualifying taxpayer's books, records, and *all* other information, *all* of which the qualifying taxpayer maintains and uses to prepare and issue its financial statements in accordance with generally accepted accounting principles (emphasis added)."

Under Navistar's limitation, R.C. 5751.53(A)(10)'s phrase "*all* other information" would not mean "*all* other information." Instead, any information that the taxpayer utilizes to restate its 2004 financial statements subsequent to the June 30, 2006 filing date would be excluded from the Commissioner's use in performing his statutorily imposed duty to audit and correct any errors until June 30, 2010.

In other words, Navistar's limitation would impermissibly add a major restriction to R.C. 5751.53(A)(10) that the General Assembly itself did not provide. Such a misreading of the statute would directly violate another basic rule of statutory interpretation: "In matters of construction, it is the duty of this court to give effect to the words used, not to delete words used or to insert words not used." *Cleveland Elec. Illum. Co. v. Cleveland*, 37 Ohio St.3d 50 (1988), paragraph three of the syllabus.

Proposition of Law No. 6:

> *As all three of Navistar's accounting witnesses testified to upon cross-examination and the Commissioner's independent accounting expert testified on direct examination, in accordance with GAAP, the books and records relating to Navistar's deferred tax assets that Navistar used to restate its 2004 values were based on the very same historical data comprising "Navistar's books and records" that Navistar used to determine the realizable value of deferred tax assets as originally filed.*

In its briefing at the BTA, Navistar asserted that the realizable value of $1.446 billion for its deferred tax assets as set forth in its originally filed financial statements for the 2004 fiscal year-end were, at the time of filing on February 15, 2005, based on GAAP-compliant books and records. Navistar has not expressly abandoned any such claims here, but may attempt to do so in it reply brief.

Any such assertion now, however, should be rejected because it is refuted by Navistar's own representations in its Restatement Financials filed with the SEC on December 7, 2007. In those Restatement Financials, Navistar disclosed that it did not "apply FASB Statement No. 109 properly" and, consequently, that it had restated the realizable value of its deferred tax assets as of the 2004 fiscal year-end to zero dollars, by taking a full, 100% value allowance. See BTA Jt. Ex. G at 107, Supp. 961; and *BTA Decision and Order* at 7-8, fn. 5 (quoting from the Restatement Financials at 107), Appx. 7-8.

Further, the underlying historical, transactional data that Navistar and its new outside CPA auditors, KPMG, LLP correctly used, in compliance with GAAP, for the Restatement Financials to reduce the realizable value of Navistar's deferred tax assets to zero as of the 2004 fiscal year-end were *the very same underlying historical, transactional data* that Navistar and its previous outside CPA auditors, Deloitte and Touche, L.L.P., *mis*used in issuing non-GAAP compliant financial statements for the 2004 fiscal year.

Just as had Dr. Stephens, in his testimony on behalf of the Commissioner, all of Navistar's witnesses having an accounting background so testified, including Navistar's own CPA tax manager, Carol Garnant. First, Ms. Garnant testified at Tr. II, 356-357 that "all of the historical information [used to restate Navistar's asset and income pursuant to the Restatement Financials]" was "in existence" at the end of the 2004 fiscal year. She then expounded on this statement, regarding the information that was utilized by Navistar for its Restatement Financials, as follows:

> Ms. Garnant: Okay. The restatement process requires the company to look back and put itself – your shoes back to October 31st,'04, *so that you're reflecting the information that is in existence at that point*, as you're saying, subsequent to that point in time as the company developed changes in the information that it was reporting. As part of its restatement financial information, we need to consider that information.

(Emphasis added.) Tr. II. at 359-360, Supp. 543-544.

Similarly, the two accounting witnesses that Navistar engaged to testify as witnesses, Douglas Pinney and Beth Savage, likewise testified to the same effect as Ms. Garnant. Mr. Pinney testified that the adjustments to income set forth in the Restatement Financials (upon which Navistar's reductions in the realizable value of its deferred tax assets to zero dollars were based) were based on the "historical data" that was in existence at the end of Navistar's 2004 fiscal year. See, Tr. II at 438-440, Supp. 622-624 (testimony of Mr. Pinney). And, Ms. Savage likewise so testified admitting that for purposes of the Restatement Financials, Navistar and its new outside CPA auditors, KPMG LLP, relied on the same "original transaction data" as did Navistar and its previous outside CPA auditors in filing Navistar's original financial statements for the 2004 fiscal year-end. See, Tr. III at 557, Supp. 741.

Finally, Navistar's and its outside CPA auditors' use of the underlying "historical transactional data" existing in Navistar's records as of October 31, 2004 plainly meets R.C. 5751.53(A)(10)'s definition of "books and records" because such data constitutes "the qualifying taxpayer's books, records, and all other information, all of which the qualifying taxpayer maintains and uses to prepare and issue its financial statements in accordance with generally accepted accounting principles (emphasis added)." Mr. Pinney expressly so stated. See Tr. II at 440, Supp. 624.

In other words, based on R.C. 5751.53(A)(10)'s definition of "books and records," Navistar's originally filed 2004 fiscal year financial statements were never GAAP-compliant because Navistar and its then-outside CPA firm auditors did not apply GAAP properly in analyzing and evaluating Navistar's "books and records" consisting of the underlying historical transactional data. Instead, only later, when Navistar and its new outside CPA auditors, KPMG LLP, re-evaluated that same historical, transactional data and issued restated financial statements for the 2004 fiscal year did Navistar's books and records become GAAP-compliant.

Had Navistar and its former outside CPA auditors, Deloitte & Touche, L.L.P. properly evaluated this underlying data in accordance with GAAP, Navistar would have issued GAAP-compliant financial statements for the 2004 fiscal year in a timely fashion in 2005. Because Navistar did not do so, it drastically overstated the realizable value of its U.S. and Canadian deferred tax assets, including its NOL carryforwards, by $1.446 billion dollars.

To be sure, pursuant to its BTA brief and through the testimony of Mr. Pinney and Ms. Savage, Navistar claimed that Navistar's non-GAAP-compliant valuation for its deferred tax assets of $1.446 billion was "reasonable," but notably, Navistar did not permit either of these witnesses to review or consider any of Navistar's books and records upon which Navistar's

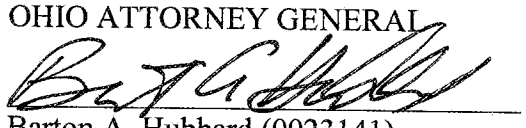
income was determined under GAAP. In other words, Mr. Pinney and Ms. Savage did not consider any of Navistar's non-compliance with GAAP that resulted in Navistar's $573 million overstatement of its net income for the 2003 and 2004 fiscal years. Nor did they consider any of the allegations that Navistar itself has set forth in its Complaint filed against Deloitte & Touche, LLP. See Tax Commissioner's BTA Ex. 8 and the Statement of Facts, supra. Only by restricting their consideration of the relevant facts, could Mr. Pinney and Ms. Savage so testify. By stark contrast, Dr. Stephens considered all of the disclosures made by Navistar in its SEC filed financial statements, as well as Navistar's various allegations in its Complaint against Deloitte & Touche LLP facts in his testimony. See, e.g., Tr. I at 171-172, Supp. 355-356.

IV.CONCLUSION

For the above reasons, the Court should affirm the decision and order of the Board of Tax Appeals affirming the Commissioner's final determination denying Navistar's R.C. 5751.53 CAT credit claim.

Respectfully submitted,

MIKE DEWINE
OHIO ATTORNEY GENERAL



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OHIO BOARD OF TAX APPEALS

Navistar, Inc.,[1]	)	CASE NO. 2010-575
	)	
Appellant,	)	(COMMERCIAL ACTIVITY TAX)
	)	
vs.	)	DECISION AND ORDER
	)	
Richard A. Levin, Tax Commissioner of Ohio,	)	
	)	
	)	
Appellee.	)	

APPEARANCES:

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Entered DEC 31 2013

Mr. Williamson, Mr. Johrendt, and Mr. Harbarger concur.

Appellant appeals a decision of the Tax Commissioner in which he rejected appellant's claimed credit against its commercial activity tax ("CAT") liability beginning in tax year 2010. We consider this matter upon appellant's notice of appeal, the transcript certified by the commissioner pursuant to R.C. 5717.02, the record of the hearing convened before this board, and the written argument submitted on behalf of the parties.

[1] In its notice of appeal, appellant advised that it was formerly known as International Truck and Engine Company, having changed its name to Navistar, Inc. in 2008.
[2] Pursuant to Ohio Adm. Code 5717-1-03(C), notice is sent to lead counsel of record.

In considering an appeal taken from a final determination issued by the Tax Commissioner, it is appropriate to acknowledge certain fundamental aspects by which our review is to be conducted. "Absent a demonstration that the commissioner's findings are clearly unreasonable or unlawful, they are presumptively valid. Furthermore, it is error for the BTA to reverse the commissioner's determination when no competent and probative evidence is presented to show that the commissioner's determination is factually incorrect. ***" *Alcan Aluminum Corp. v. Limbach* (1989), 42 Ohio St.3d 121, 124. (Citation omitted.) Accordingly, a taxpayer must rebut the aforementioned presumption and establish a clear right to the relief requested. As noted by the court in *Nusseibeh v. Zaino*, 98 Ohio St.3d 292, 2003-Ohio-855:

> "In *Federated Dept. Stores, Inc. v. Lindley* (1983), 5 Ohio St.3d 213, 215, *** we stated that 'when an assessment is contested, the taxpayer has the burden "*** to show in what manner and to what extent ***" the commissioner's investigation and audit, and the findings and assessments based thereon, were faulty and incorrect.' (Ellipses sic.) Id., quoting *Midwest Transfer Co. v. Porterfield* (1968), 13 Ohio St.2d 138, 141, ***." Id. at ¶10. (Parallel citations omitted.)

The present appeal involves the extent to which appellant may benefit from a credit applied against the CAT, a tax phased in by the Ohio General Assembly beginning in 2005 which, for many companies, served to replace the taxes imposed on personal property located and used in business in Ohio, see, generally, R.C. Chapter 5719, and the privilege of exercising a corporate franchise within the state. See, generally, R.C. 5733.01(G)(1) and (2). With respect to the former corporate franchise tax, businesses not having positive net income accumulated net operating losses which could be carried forward and deducted against future corporate franchise tax liability, recorded as a deferred tax asset on their financial statements.

Recognizing that the state's transition to the CAT would result in loss of the financial value of the net operating loss carry-forward, the General Assembly established a one-time CAT credit that allowed a percentage conversion of this corporate franchise net operating loss tax credit to serve as a credit against future CAT liability. In order to take advantage of this conversion credit, a qualifying taxpayer, i.e., one with $50 million in unused franchise net operating loss carryforward, was required to file a report prior to July 1, 2006 disclosing the value of its deferred tax assets as of its taxable year ending in 2004 which, with certain specific adjustments, was referred to as the "amortizable amount."[3] In allowing for this credit, the statute required that the amortizable amount be calculated using the taxpayer's books and records as reflected on the last day of its taxable year ending in 2004. See R.C. 5751.53(A)(6) and (8). R.C. 5751.53(A)(10) defines "books and records" to mean "the qualifying taxpayer's books, records, and all other information, all of which the qualifying taxpayer maintains and uses to prepare and issue its financial statements in accordance with generally accepted

---

[3] R.C. 5751.53(A)(9) defines "amortizable amount," as follows:

> "'Amortizable amount' means:
>
> "(a) If the qualifying taxpayer's other net deferred tax items apportioned to this state is equal to or greater than zero, eight per cent of the sum of the qualifying taxpayer's disallowed Ohio net operating loss carryforward and the qualifying taxpayer's other net deferred tax items apportioned to this state;
>
> "(b) If the amount of the qualifying taxpayer's other net deferred tax items apportioned to this state is less than zero and if the absolute value of the amount of qualifying taxpayer's other net deferred tax items apportioned to this state is less than the qualifying taxpayer's disallowed net operating loss, eight per cent of the difference between the qualifying taxpayer's disallowed net operating loss carryforward and the absolute value of the qualifying taxpayer's other net deferred tax items apportioned to this state;
>
> "(c) If the amount of the qualifying taxpayer's other net deferred tax items apportioned to this state is less than zero and if the absolute value of the amount of qualifying taxpayer's other net deferred tax items apportioned to this state is

accounting principles." Following submission of the aforementioned report, the Tax Commissioner was accorded until June 30, 2010 to "audit the accuracy of the amortizable amount available to each taxpayer that will claim the credit, and adjust the amortizable amount or, if appropriate, issue any assessment or final determination, as applicable, necessary to correct any errors found upon audit." R.C. 5751.53(D). Once approved, use of the credit is then spread out over a period extending from calendar years 2010 through 2030.

In this instance, appellant submitted the required report in June 2006 claiming an amortizable amount of $27,048,726 which was reviewed and ultimately reduced by the Tax Commissioner to zero due to appellant's subsequent restatement of its financial statements. The commissioner explained, in pertinent part, in his final determination as follows:

> "Information in the file indicates that the Navistar International Corporation, the parent of the taxpayer in this case, issued restated financial statements, Form 10-K/A, in December 2007. These restated financial statements revised the valuation allowance to one hundred percent as it relates to the taxpayer's disallowed Ohio net operating loss carryforwards and other net deferred tax items apportioned to Ohio that are reflected as net deferred tax assets in its restated financial statements with respect to its financial statements for years ending October 31, 2004 and October 31, 2005.
>
> "***
>
> "Under the above statutory language[, i.e., R.C. 5751.53(A)(10)], the taxpayer's revised financial statements are the best financial statements available pursuant to generally accepted accounting principles, and therefore should be used to determine if a credit is available. ***
>
> "In the instant case, when Navistar adjusted its financial statements via its revised Form 10-K/A, these revised financial statements became the most up-to-date and accurate financial statements for

Footnote contd. ——————————

equal to or greater than the qualifying taxpayer's disallowed net operating loss, zero."

> Navistar under generally accepted accounting principles, and Navistar was bound by these records ***. Although the taxpayer's representative argues for the use of the prior, superseded financial statements rather than the corrected and revised financial statements, Ohio law dictates that the corrected financial statements be used. The taxpayer's representative failed to show that the prior, superseded financial statements that it wishes to use are more accurate than the revised financial statements.
>
> "As stated above, the taxpayer, in its revised financial statements took a valuation allowance equal to one hundred percent of its disallowed Ohio net operating loss carryforwards and net deferred tax assets allocated to Ohio. As a result of this revision to the financial statements, there is no disallowed Ohio net operating loss carryforward for which to take the CAT credit against.
>
> "Therefore, pursuant to R.C. 5751.53(D), the Tax Commissioner hereby adjusts the amortizable amount, as defined in R.C. 5751.53(A)(9), in accordance with the audit conducted by the Tax Commissioner's agents, to zero." S.T. 1-3.

From this determination, appellant appealed to this board, arguing that its originally submitted amortizable amount should be accepted since it complied with the statutory conditions set forth in R.C. 5751.53. Appellant insists that the amounts which it was required to use in preparing its report and to calculate the amortizable amount were those which appeared on its books and records at the close of its taxable year ending in 2004 and that there existed no statutory provision for the commissioner to extend the deadline to which qualifying taxpayers were required to adhere in filing the required report. While not disputing that it restated its financial statements for its taxable year ending in 2004, appellant insists that since this was not completed until almost eighteen months after the required election, it properly complied with the statutory provisions and the commissioner is without authority to disallow its claimed credit based upon its restated financial statements.

We agree with appellant's general characterization of this appeal, i.e., "[w]hile the statutory formula and calculations themselves [involving the CAT and the credit which appellant claims entitlement to] are technical and detailed, the issue in this case is quite straightforward." Appellant's brief at 3. Both the appellant and the commissioner were required to adhere to certain statutory deadlines, i.e., the former to file the requisite report prior to July 1, 2006, and the latter to audit the accuracy of the amount of the credit claimed, absent agreed extension, and issue any assessment or final determination by June 30, 2010. However, contrary to appellant's position, the commissioner is neither restricted with respect to the type nor timeframe of information which may be reviewed or considered as part of the audit undertaken, with the express authority granted him to adjust the amortizable amount in order to "correct *any errors* found upon audit." (Emphasis added.)

It is uncontested appellant undertook a comprehensive restatement of its financial statements so that they were ultimately revised in accordance with generally accepted accounting principles. Although appellant insists that the commissioner acted improperly by considering and relying upon its later restated financial statements, at the time of its filing of its amortizable amount report with the Department of Taxation, appellant's assistant director of tax expressly disclosed that it was "currently undergoing a restatement of its financial statements for the years 2002, 2003, 2004 and 2005. We believe that changes will occur to the 2002, 2003 and 2004 financial statements as part of this examination which will impact the return and report that we are filing today."[4] Tax Commissioner's Ex. 6.

[4] While we acknowledge the commissioner's reference to the existence of litigation between appellant and the accounting firm previously involved in the audit of its financial returns, such litigation and the allegations made by appellant therein need not serve as the basis upon which we decide this matter given the grant

Consistent with the disclosure made to the commissioner, appellant likewise apprised the Securities and Exchange Commission of the errors in its previously filed financial statements. See Appellant's Form 10-K, Joint Ex. G, at 107.[5] The result of restating its financial statements in accordance with generally accepted accounting principles served to reduce appellant's net operating losses to zero which is consistent with the action taken by the commissioner.

Appellant's arguments that the Tax Commissioner is restricted in his consideration to only its original financial statements, despite the admitted inaccuracies contained therein, is in contradiction with R.C. 5751.53(A)(10) which requires that such statements be "prepare[d] and issue[d] *** *in accordance with generally accepted accounting principles*." (Emphasis added.) Further support for this reasoning exists in our decision in *Shook Natl. Corp. v. Tracy* (Dec. 23, 1992), BTA No. 1990-X-1596, unreported, wherein we rejected the commissioner's overly restrictive view that the taxpayer was bound by erroneous entries contained in its books, resulting from a misapplication of generally accepted accounting principles, because they had not been discovered and restated until several years subsequent to the tax year in issue. Despite this delay, in order to achieve a more accurate calculation of tax liability, we held that the taxpayer was entitled to use its amended books which had been corrected to comport with generally accepted accounting principles. We find

Footnote contd. ——————————

provided by R.C. 5751.53(D). We also reject as unfounded appellant's argument that the commissioner's witness, Professor Ray Stephens, be found unqualified to offer an expert opinion regarding the accounting issues involved herein.

[5] In its Form 10-K, appellant stated, in part: "In addition, in previously issued financial statements, we had established a partial valuation allowance with respect to our net U.S. and Canadian deferred tax assets. We reassessed our need for a valuation allowance and determined that *we did not apply FASB Statement No. 109 properly* and that a full valuation allowance should be established for net U.S. and Canadian deferred tax

the same to be true in this instance. Cf. *Natl. Tube Co. v. Peck* (1953), 159 Ohio St. 98; *SHV N. Am. Corp. v. Tracy* (1994), 70 Ohio St.3d 395.

In the present case, the Tax Commissioner properly exercised the authority granted him by R.C. 5751.53(D) to "audit the accuracy of the amortizable amount available to each taxpayer that will claim the credit, and adjust the amortizable amount or, if appropriate, issue any assessment or final determination, as applicable, necessary to correct any errors found upon audit." The "errors" in issue were those preliminarily identified by appellant, confirmed by its filing with of restated financial statements, and ultimately served as the basis for the adjustment to the amortizable amount effected by the commissioner. We are therefore unable to conclude that appellant has demonstrated that the audit, findings, and adjustment made by the Tax Commissioner were either faulty or incorrect. Accordingly, it is the decision of the Board of Tax Appeals that the Tax Commissioner's final determination must be, and hereby is, affirmed.

I hereby certify the foregoing to be a true and complete copy of the action taken by the Board of Tax Appeals of the State of Ohio and entered upon its journal this day, with respect to the captioned matter.

A.J. Groeber, Board Secretary

Footnote contd. ——————————

assets based on the weight of positive and negative evidence, particularly our recent history of operating losses." Id. (Emphasis added.)

1992 WL 402645 (Ohio Bd.Tax.App.)

Board of Tax Appeals

State of Ohio

SHOOK NATIONAL CORPORATION, APPELLANT

v.

ROGER W. **TRACY**, TAX **COMMISSIONER** OF OHIO

CASE NO. 90-X-1596

December 23, 1992

***1 CORPORATE FRANCHISE TAX**

DECISION AND ORDER

APPEARANCES:

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This cause and matter came on to be considered by the Board of Tax Appeals upon a notice of appeal filed herein by **Shook** National Corporation ("Appellant") from a certificate of final determination of the Tax **Commissioner** ("Appellee") dated October 30, 1990, wherein that official denied appellant's refund claim for franchise taxes paid for the tax year 1987. The notice of appeal provides:

"SPECIFICATION OF ERRORS

"The Appellant specifically complains of the following errors in the **Commissioner's** order:

I

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FIRST ASSIGNMENT OF ERROR

"The Tax **Commissioner** erred in her determination that O.R.C. 5733.05(A) requires that the value of appellant's issued and outstanding stock, as measured by its net worth as of December 31, 1986, may not be determined by reference to appellant's books kept in the ordinary course of business, as adjusted to bring such books into compliance with generally accepted accounting principles.

II

SECOND ASSIGNMENT OF ERROR

"The Tax **Commissioner** erred in her determination that the case Eaton–Kenway v. Limbach, (sic) (November 23, 1987) B.T.A. No. 85–G–655, requires that any adjustments necessary to bring a taxpayer's books and accounting records into compliance with generally accepted accounting principles must be made prior to the end of the taxable period at issue.

III

THIRD ASSIGNMENT OF ERROR

"The decision of the Tax **Commissioner** is arbitrary, erroneous, unreasonable and contrary to law."

The **Commissioner's** journal entry provides as follows:
"This matter, having been duly heard, now comes up for final determination. It involves a claim pursuant to R.C. 5733.12 for a refund of $44,270.

"The applicant contends that the value of its issued and outstanding stock as measured by its net worth was overstated due to an accounting error which occurred during the 1986 taxable year (tax year 1987), but which was not corrected on its books until subsequent to the closing of its books. This contention is not well taken.

"R.C. 5733.05(A) provides that the value of a corporation's issued and outstanding shares of stock calculated under the net worth basis shall be determined 'as of the date shown by the report to have been the beginning of the corporation's annual accounting period that includes the first day of January of the tax year.' (Emphasis added.) R.C. 5733.05(A) further requires that such value is to be the 'total value, as shown by the books of the company, of its capital, surplus, whether earned or unearned, undivided profits, and reserves ***.' (Emphasis added.) In National Tube Co. v. Peck (1953), 159 Ohio St. 98, the Ohio Supreme Court held that General Code Section 5498, the predecessor to R.C. 5733.05(A), required the value of the issued and outstanding shares of a corporation to be determined 'from the books of the corporation which [are] generally regarded as the accounting records of such corporation and [are] kept in the ordinary course of business in accordance with any sound and generally recognized and approved accounting system ***.'

***2** "As of the beginning date of the applicant's accounting period for which the total value of the applicant's stock has been determined, its books did not reflect the subsequent accounting adjustments. As the Court noted in National Tube, supra, it is of no consequence that the actual value of the corporation's shares of stock may differ from what is shown by its books.

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"Furthermore, in Eaton–Kenway the taxpayer therein discovered during tax year 1980 errors made during the taxable year ending December 31, 1979. While the Board of Tax Appeals held in Eaton–Kenway, Inc. v. Limbach (Nov. 23, 1987), B.T.A. No. 85–G–655, unreported, that '*** where a taxpayer has shown that due to errors, its books do not properly reflect the value of its issued and outstanding shares of stock, the necessary adjustment should be made. However, the taxpayer [therein had] not shown through probative evidence that the books for the period at issue were in fact changed to correct the alleged accounting errors.' Thus, if a taxpayer can show through probative evidence that an error was discovered after the close of its books but that its books were properly restated before the end of the applicable tax year, the Board's decision in Eaton–Kenway would permit the taxpayer to recompute its Ohio franchise tax liability based upon the restated figures.

"In the matter herein, the taxable year at issue ended December 31, 1986 and the applicable tax year was 1987. The applicant discovered the error in September 1988 and corrected its books sometime during September or October 1988. The applicant submitted evidence that it corrected its General Ledger Trial Balance for the period December 1986. Even if the General Ledger Trial Balance is accepted as 'the books' of the applicant, the applicant did not make the correction during the 1987 tax year. Rather, the General Ledger Trial Balance was corrected during tax year 1988. Thus, the applicant's actions do not come within the requirements of Eaton–Kenway and the refund claim was properly denied.

"Accordingly, the subject refund claim is hereby denied."

Counsel for both parties entered into a partial stipulation of facts, as follows:
"1. **Shook** National Corporation ('Appellant') is an Ohio corporation, incorporated on June 18, 1986.

"2. Appellant's books and records are maintained on the accrual method of accounting.

"3. Appellant's fiscal year is the calendar year.

"4. For purposes of this case, Appellant's assets include the shares of stock of **Shook**, Inc. (the 'Subsidiary Stock'), its wholly owned corporate subsidiary, as well as the stock of three of its other wholly-owned subsidiaries, including S.E.I. Co. ('SEI'), ABS, Inc. ('ABS'), and **Shook**, Inc. of West Virginia ('WVa Co').

"5. Appellant acquired the Subsidiary Stock on September 30, 1986.

"6. On September 30, 1986, Appellant also acquired the stock of SEI, ABS, and WVa Co.

"7. Sometime in late 1986 or early 1987, Appellant's then-outside certified public accounting firm ('Prior Accountants') recommended to Appellant that it make certain adjusting entries in connection with the formation of Appellant. (as set out on Exhibit 1)

***3** "8. The intended purpose of these recommended entries would be to record in Appellant's books and records the book value of the investment in the Subsidiary Stock and the stock of the other subsidiaries at the fair market value of the investments, rather than at the historic cost of the investments.

"9. In accordance with those recommendations, Appellant thereafter recorded by computer input the entries (the '1986 Entries'), as recommended by the Prior Accountants on Exhibit 1, into Appellant's general ledger for 1986 (attached hereto as Exhibit 2 and herein called the '1986 General Ledger') and identified those entries in the 1986 General Ledger by the references: 'JE–01', 'JE–02', and 'JE–12.'

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"10. The 1986 Entries from the General Ledger were incorporated into Appellant's computer generated general ledger trial balance (the '1986 Trial Balance') and Appellant's balance sheet (the '1986 Balance Sheet') for the year ended December 31, 1986, which were prepared in or around March, 1987, and which are attached hereto as Exhibit 3 and Exhibit 4, respectively.

"11. The 1986 General Ledger, 1986 Trial Balance, and the 1986 Balance Sheet did not originally include any handwritten adjusting entries thereon.

"12. Appellant timely filed its 1987 Ohio Corporation Franchise Tax Report based on then-available financial data for its year-ended December 31, 1986, and that return is attached hereto as Exhibit 5 ('Original 1987 FT–1120').

"13. Appellant's Original 1987 FT–1120 incorporated the 1986 Entries, as originally input through the computer, on its Schedule F Balance Sheet and on its Schedule H Computation of Taxable Value.

"14. The following authoritative pronouncements are included in the body of knowledge recognized by the accounting profession as 'Generally Accepted Accounting Principles:'
"a. 'Statements' of the Financial Accounting Standards Board;

"b. 'Opinions' of the Accounting Principles Board;

"c. 'Accounting Research Bulletins' issued by the American Institute of Certified Public Accountants Committee on Accounting Procedure; and

"15. Accounting Principles Board Opinion 16 ('APB 16') is a part of Generally Accepted Accounting Principles and is attached hereto as Exhibit 6.

"16. In late 1987, Appellant retained a new outside certified public accounting firm, Touche Ross & Co. (n/k/a Deloitte & Touche) (herein called 'Touche').

"17. Touche thereafter performed the audit of Appellant's financial statements for the year ended December 31, 1987.

"18. [deleted]

"19 Touche's audit report for the year ended December 31, 1987, is attached hereto as Exhibit 8 ('1987 Financial Statements').

"20 Thereafter, Touche prepared an 'Accountant's Compilation Report' for the year ended December 31, 1986, issued September 20, 1991, and attached hereto as Exhibit 9, ('Accountant's Compilation Report').

"21. Thereafter, Appellant delivered copies of the Accountant's Compilation Report with accompanying cover letters to the individuals and institutions identified in Exhibits 10(a), 10(b), 10(c), and 10(d)."

***4** This case involves the September 30, 1986, acquisition by **Shook** National of another company, called **Shook**, Inc., referred to in paragraph four of the stipulation. Counsel for the appellant succinctly writes the instant dispute relates to "(1) the financial accounting label for that transaction, and (2) the time frame in which that label can be made and corrected." (Appellant's Brief page 2.)

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This matter was submitted to the Board of Tax Appeals upon the notice of appeal, the statutory transcript certified herein by the Tax **Commissioner**, the evidence adduced at the hearing conducted herein, and the written legal briefs filed by counsel for both parties.

Shook National was formed in 1986 by the shareholders of **Shook**, Inc., who exchanged their shares of common stock in **Shook**, Inc. for an equal number of shares in **Shook** National. As a result, these shareholders became the shareholders of **Shook** National, and **Shook**, Inc. became a wholly-owned subsidiary of **Shook** National.

Appellant paid its 1987 franchise taxes based on its net worth as reflected on its books. However, appellant now claims its prior accountants made a mistake in an application of accounting principles—a mistake which considerably inflated its net worth in its books. The prior accountants recorded **Shook** National's investment in **Shook**, Inc. at its fair market value pursuant to the purchase accounting method, rather than at its historic cost pursuant to traditional accounting method.

Appellant claims its new accountants, Deloitte & Touche, discovered the error in early 1988, and made a recommendation to appellant that adjusting entries be made on its 1987 books to correct the mistake. (R. 23, 24.) The intended purpose of this correction was to record **Shook** National's acquisition of the **Shook** Inc. stock at the stock's historical cost, rather than at its fair market value.

The correction reduced the appellant's net worth. Accordingly, the appellant timely filed a claim for franchise tax refund, pursuant to R.C. 5733.12, which provides in pertinent part:
"*********

"(B)(1) An application to refund to the corporation the amount of taxes overpaid, paid illegally or erroneously, or paid on any illegal, erroneous, or excessive assessment, with interest thereon as provided by section 5733.26 of the Revised Code, shall be filed with the tax **commissioner**, on the form prescribed by him, as follows:

"(a) Within three years from the date of the illegal, erroneous, or excessive payment of the tax;

"*********

After that claim was denied, the appellant filed this appeal, and also made further corrections to its books. Upon the advice of Deloitte & Touche, the appellant went back to its 1986 books, made the correction in the value of the **Shook**, Inc. stock, then took the correction "out of" its 1987 books. (R. 50.) The appellant takes the position its books and general ledger then accurately reflected appellant's September, 1986, acquisition of **Shook**, Inc. stock. Letters were sent out in October, 1991, to shareholders, board members, Bank One Dayton, and the appellant's bonding company notifying the parties of the correction and change in the company's net worth. (R. 34, Exhibits 10a, b, c, d.)

***5** The syllabus of the Supreme Court in Hatchadorian v. Lindley (1986), 21 Ohio St.3d 66 reads as follows, at paragraph one,

> "1. The Tax **Commissioner's** findings are presumptively valid, absent a demonstration that those findings are clearly unreasonable or unlawful."

The burden of offering competent and probative evidence is on the party who challenges the **Commissioner's** determination. Hatchadorian v. Lindley, supra; Alcan Aluminum Corp. v. Limbach (1989), 42 Ohio St.3d 121.

In the present matter, the **Commissioner** appears to have relied upon Eaton–Kenway, Inc., supra, for the proposition that any erroneous entries in a taxpayer's books must be properly restated before the end of the applicable tax year, or the taxpayer is bound by them. We do not read Eaton–Kenway, supra, as authority for the Tax **Commissioner's** position, nor are we aware of

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any other authority. The taxpayer in Eaton–Kenway did not show through probative evidence that adjustments had ever been made to the alleged accounting error, and that is why this Board affirmed the Tax **Commissioner's** final order.

Given the above, we believe the appellant has rebutted the presumption of correctness normally accorded the **Commissioner's** findings. Appellant's second specification of error is sustained.

We will now turn to the issue of whether the appellant has introduced sufficient competent and probative evidence to establish that its net worth on January 1, 1987, was negative $2.4 million, for the purposes of Ohio franchise tax. (R. 74.)

R.C. 5733.01 imposes a corporation franchise tax on corporations organized for profit under the law of the state of Ohio for the privilege of exercising their corporate franchise. The tax is first computed on a net income basis and then on a net worth basis. Payment is determined on the higher yielding tax. R.C. 5733.05.

Net worth is an accounting term which, simply defined, is the value of the corporation owned by the shareholders. Net worth is calculated by adding together the assets of the corporation and subtracting the liabilities. The remainder is the corporation's net worth. For Ohio franchise tax purposes, net worth is defined as the total value, as shown on the books of the company of the company's capital, surplus, undivided profits and reserves. R.C. 5733.05(a); see, also: Ohio Adm.Code 5703–5–08.

The value of an asset as carried on the corporation's books obviously effects the net worth of the corporation. In the case of cash, the value is the actual amount held by the corporation at any given moment of time. In the case of an asset such as an investment, the value as carried on the books may be higher or lower than the actual value at the moment of time the asset is reported.

A corporation is bound by its books and records, as kept in the ordinary course of business. In National Tube Co. v. Peck (1953), 159 Ohio St. 99, the taxpayer listed its inventories on its Ohio Franchise Tax Report as they were listed in its general ledger accounts. The **Commissioner** increased the value of the inventory as recorded on the general ledger accounts, thereby increasing the value of the capital surplus account.

***6** The Ohio Supreme Court overturned the actions of the Tax **Commissioner**. In that case, the Court noted the taxpayer employed a recognized method of accounting, and used its figures consistently. The Court concluded the **commissioner** was required to find the valuations were reported in a correct manner, and carried through to the net worth accounts appropriately. Herein, the **Commissioner** cites National Tube, supra, for the proposition that "it is of no consequence that the actual value of the corporation's shares of stock may differ from what is shown by its books." While this may be true in some cases, it does not mean a taxpayer is never legally entitled to amend its books and tax returns upon discovering a discrepancy between the value of an asset and its reported book value.

Herein, the appellant introduced the testimony of Mr. Robert V. Hoffman, the Treasurer of **Shook** National (and a fourteen-year employee), and that of Mr. Thomas R. Mann, the Senior Manager of Deloitte & Touche's audit department, to explain at length the origin of the alleged accounting mistake, and the reasons for correcting it. Also, the appellant amply established through exhibits what the uncorrected books looked like, and what manual changes were made.

The 1986 transaction at issue (in which **Shook** National acquired **Shook**, Inc.) was not recorded on **Shook** National's books until March of 1987. [1] When the stock acquisition was recorded, appellant's prior accountants recommended booking it as of its purchase price of $3,000.00 for each of the 4,700 shares traded (for a total of $14,100,000.00). (Exhibit 12.) As discussed above, the accountants at Deloitte & Touche later informed the appellant this was not done in accordance with generally accepted accounting principles (GAAP), which is the only recognized and approved accounting system. (R. 67.) Mr. Mann explained as follows during the hearing:

"Q. |Counsel for AppellantŒ Mr. Mann, based on your accounting knowledge, are the journal entries in Exhibit 2–A recorded in accordance with APB–16 |Accounting Principles Board Opinion 16, Exhibit 6Œ. (Exhibit 2–A depicts the entries made by the prior accountants.)

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"A. [Mr. MannŒ The journal entries in that exhibit, the result from those journal entries do not record the transaction in accordance with APB No. 16.

"Q. And were they done in accordance with GAPP (sic)?

"A. No, they were not.

"Q. Why were they not in accordance with GAPP (sic)?

"A. The effect of those journal entries were to record the transaction, the merger that occurred using purchase accounting which is described in APB–16. In the situation that occurred, the transaction was not a business combination as defined in APB No. 16 and, therefore, that transaction and those journal entries were recorded in error.

"Q. What about the transaction caused it not to be a business combination within the meaning of APB–16?

"A. APB–16 defines business combinations and it also defines a case where a business combination does not occur. One of those cases being where a change of control does not occur. So if a change of control in a combination of entities does not occur, that the shareholder group essentially remains the same, then a business combination did not occur. Therefore, purchase accounting and APB–16 do not apply.

*7 "*********

"Q. In this case, there was not change of control?

"A. Correct.

"Q. There was no change of control because the shareholders of **Shook**, Inc. became the shareholders of **Shook** National?

"A. That is correct.

(R. 68, 69.)

Mr. Mann went on to testify that the historical cost basis of the **Shook**, Inc. stock is the value that should have been used. (R. 92, 102–103.) He concluded that GAAP requires a taxpayer to go back and correct its books. (R. 108.) Here, the taxpayer discovered the mistake in late 1987, and made the first step in correcting it in April, 1988, which is well within the applicable statute of limitations.

Both parties discuss the cases Gray Horse, Inc. v. Limbach (August 7, 1992), B.T.A. Case No. 89–M–33, unreported, and American National Bank v. Limbach (August 14, 1992), B.T.A. Case No. 90–J–94, unreported. In Gray Horse, the taxpayer had a discrepancy between its Federal Corporate Income Tax Return and its Ohio Franchise Tax Returns, due to the fact it used two different amounts when reporting the value of a certain stock. In affirming the **Commissioner**, we wrote:

> "*** to afford the taxpayer the luxury of inflating the value of its stock for federal income tax purposes to receive certain benefits and using the book value of the stock for Ohio Franchise tax purposes to receive other benefits would afford the taxpayer a windfall. Appellant's witness admits he inflated the value of the stock for federal income tax purposes so that the corporation would have the substance to pay a shareholder a $100,000 salary for managing corporate affairs. *** As the corporation procured a benefit from its method

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of accounting, we find that it is not unreasonable to require the corporation to consistently report its asset valuation."

In American National Bank, the taxpayer wanted to amend its franchise tax payment due to the fact it improperly included in its original return the proceeds generated by the sale of stock, which sale was not finalized until after the January 1, 1988, tax listing date. However, the proceeds were listed in the bank's Annual Report, so that the bank would not have to report a negative net worth to its shareholders. There was no evidence the bank subsequently modified the corporate books or Annual Report to present the transaction in the "correct" light. We wrote:
"The appellant benefited from reporting the proceeds as part of its 'net worth' as of December 31, 1987. The decision to include the proceeds was made deliberately, and in accordance with the express opinion of the appellant's certified public accountants. ***

"*** Had the proceeds of the sale not been included in the year end reports, it is very likely that the appellant would not have remained in existence. Its 'net worth' was increased to its benefit as a result of including the proceeds of the sale on its reports which are closely scrutinized within the financial community."

***8** In America National Bank, supra, we affirmed the **Commissioner's** final determination which found the appellant's 1987 financial statements properly reflected the sale of the preferred stock, making a denial of the refund claim proper.

We are not persuaded by appellee's arguments that the taxpayer in this case acted in the same manner as those discussed above. The **Commissioner** was not able to point out any benefit which would have inured to the taxpayer as a result of the incorrect journal entry. There are only four shareholders; it does not appear any of them were misled. (Exhibits 12, 13, 14.) The record does not present any obvious reason why the taxpayer would manipulate the stock values. The appellant did not use the values inconsistently, and further, has thoroughly corrected the mistake and notified all who are concerned. The appellant has put on a great deal of credible and convincing evidence to establish its prior accountants' recommendation simply fell below accepted accounting standards, and that the reported value of the stock (and therefore, appellant's net worth) is other than that claimed by the Tax **Commissioner**.

In spite of the complicated accounting background of this case, we liken it to Yang–Guu Chen, M.D. Inc. (Dec. 27, 1991), B.T.A. Case No. 89–F–1087, unreported, in which the taxpayer's retained earnings were overstated when his accountant accidentally did not take into account pension and profit sharing expenses. The **Commissioner** denied the refund claim for the taxpayer's 1988 Ohio Corporate Franchise Tax Return, noting the error was not discovered until February, 1989. We, however, noted the appellant had clearly complied with the statute of limitations (R.C. 5733.12), and that the error appeared to be simply that—a mistake. We held: "Upon the facts presented in this record we find that appellant simply made an error in his 1988 FT 1120 originally filed, resulting in an overpayment of Ohio Franchise Tax. On this basis, appellant is entitled to the refund as claimed."

Similarly, we find the appellant has established a misapplication of accounting principles occurred, which inflated the appellant's net worth for tax year 1987. The appellant did not derive any benefit from this. The appellant did not purposefully manipulate the values to gain a business advantage. The appellant has demonstrated good faith in correcting the error in compliance with GAAP, and has notified those involved. Lastly, the appellant has established with sufficient probative and competent evidence that the **Shook**, Inc. stock should properly have been booked at its historical cost. The **Commissioner** has failed to rebut this evidence. We therefore find the appellant's net worth as of December 31, 1986, is determined by reference to the appellant's books, as adjusted in accordance with generally accepted accounting principles.

Accordingly, it is the finding and determination of the Board of Tax Appeals, based upon a consideration of the record and the law applicable thereto, that the decision of the Tax **Commissioner** is erroneous for the reasons set forth heretofore, and it should be, and hereby is, reversed.

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I hereby certify the foregoing to be a true and correct copy of the action of the Board of Tax Appeals of the State of Ohio, this day taken, with respect to the above matter.

***9** Kiehner Johnson
Chairman

Footnotes

1 R.C. 5733.05 provides in pertinent part: "The annual corporation report determines the value of the issued and outstanding shares of stock of the taxpayer ***. Such determination shall be made as of the date shown by the report to have been the beginning of the corporation's annual accounting period that includes the first day of January of the tax year." Given the foregoing, on January 1, 1987, the books would not have reflected any value for the newly-acquired **Shook**, Inc. stock, since the transaction had not been recorded.

1992 WL 402645 (Ohio Bd.Tax.App.)

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CERTIFICATE OF SERVICE

I hereby certify that on this 27th day of October, 2014, a copy of the foregoing Brief of Appellee Commissioner was served by regular U.S. Mail on appellant's counsel of record, Maryann B. Gall, at the address below, and by email transmission to Ms. Gall, Laura A. Kulwicki, and Steven L. Smiseck.

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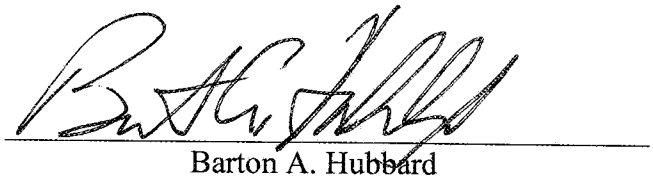

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